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SUBJECT: STIMULUS BOOSTING GROWTH, SHANGHAI ANALYST TELLS CODEL
BOEHNER

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distribution outside USG channels.

¶1. (SBU) Summary: China's economy is likely to achieve the
Central Government's 8 percent growth target this year, a
Shanghai-based investment bank analyst told CODEL Boehner on
August 11. However, much of the growth is a result of Beijing's
economic stimulus measures, which are non-transparent and
potentially could lead to large non-performing loans in the
medium term. The analyst also noted concerns about China's high
unemployment and high public debt. End summary.

¶2. (SBU) A six-member Congressional delegation led by House
Minority Leader John Boehner (R-OH) met with Standard Chartered
Bank China Research Head Stephen Green August 11. The
delegation also included Dan Boren (D-OK), Jo Bonner (R-AL),
Dave Camp (R-MI), Tom Latham (R-IA), and Greg Walden (R-OR). In
addition to the session with Standard Chartered's Green, the
delegation visited the Semiconductor Manufacturing International
Corporation (SMIC) and met with members of the American Chamber
of Commerce in Shanghai.

China's Economy is Picking Up Speed...

13. (SBU) Green cited several alternative indicators to support his main point that China's economy is taking a turn for the better. Year-on-year growth in the freight index, for example, fell to negative 10 percent in early 2009, but is now on an upward trend, reaching 5 percent growth by May. The turnaround, given China's continuing negative export growth, has been especially clear in domestic container activity: movement of containers through inland river ports rose almost 30 percent year-on-year in May, while that of coastal ports remained in the negative 10 percent range.

14. (SBU) Green said electricity production and Standard Chartered's industrial output index also indicate the recovery is underway. However, he noted there is a divergence in these two series. (Comment: Other analysts have noted that electricity production may no longer be an accurate indicator of Chinese economic activity. End comment.) While year-on-year electricity production growth fell sharply negative in October 2008 and remained negative until May 2009 -- a U-shaped recession -- Green's analysis of industrial activity shows a more V-shaped recession, with a quick recovery in February 2009. According to Green, at one point there was a 20 percent gap between electricity production and industrial activity.

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15. (SBU) According to his analysis of other non-traditional data sets such as freight activity or electricity production, Green said he is confident the Chinese government will be able to meet its 8 percent GDP growth target by the end of the year. Standard Chartered's forecast is 8.5 percent GDP growth this year, ticking up to 8.9 percent in 2010 as a result of continuing stimulus measures, and then pulling back to 8.1 percent in 2011. Green described these forecast figures as conservative compared with some other investment banks, which project a return to double-digit growth by 2010.

...Thanks to Beijing's Stimulus Spending

16. (SBU) Seventy to eighty percent of China's recent growth is a result of Beijing's economic stimulus measures, estimated Green. However, he cautioned that it is difficult to know exactly because the spending under the stimulus plan is not well defined. Beijing first announced a RMB 4 trillion (approximately USD 587 billion) package in October, and local governments then submitted wish lists of over RMB 20 trillion. Over the past several months, said Green, the Central Government approved tranches of projects likely to amount to significantly more than RMB 4 trillion.

17. (SBU) In addition, said Green, approximately half of the RMB 7 trillion (approximately USD 1 trillion) in new bank lending during the first half of the year contributed to stimulus projects. In the medium to long term -- starting in five years or so -- about half of the new lending from banks over the past several months is likely to go bad, said Green. The banks at

present feel that they have a government guarantee on these loans, since they were responding to government pressure to lend to stimulus-related projects. However, said Green, no one knows what will happen when the projects are completed and they prove not to be economically viable, with little or no return on investment.

Social Problems: Unemployment...

18. (SBU) Green said that his best guess is that the urban jobless rate is currently around 10 percent of the total urban workforce. He said that he has no confidence in the official

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unemployment statistics, which he characterized as "the worst numbers out there" because of their failure to account for unemployment in the migrant worker population. (Note: On August 4 the State Council Information Office announced that registered urban unemployment in the first half of the year remained stable at 4.3 percent. End note.) The stimulus package will not necessarily improve the employment situation because there is a mismatch between the export-processing jobs lost in the downturn and the jobs created by the stimulus program, Green said. For example, export processing jobs are usually held by young women aged 18-25 years, but few of these would be able to transition to working on infrastructure projects.

...And High Public Debt

19. (SBU) Green told CODEL Boehner Chinese interlocutors often express concerns about the size of the U.S. budget deficit and overall U.S. government debt, but he responds to these concerns by pointing out China's budget and debt numbers are actually closer to those of the United States than most people realize. For instance, China's deficit this year is around 4 percent of China's GDP. Since most of the economic stimulus financing is being routed through the banking system rather than the national budget, however, the deficit also should take into account the Chinese bank-financed stimulus. In this case, Green stated, the percentage of GDP rises to 9 or 10 percent, very close to the U.S. deficit numbers as a percent of U.S. GDP. Likewise, China's public debt is approximately 20 percent of China's GDP, but if contingent liabilities -- including the likely non-performing loans resulting from the stimulus program -- are included, China's public debt rises to 80 or 90 percent of GDP, comparable to U.S. figures.

Businesses Riding Stimulus Wave

¶10. (SBU) Businessmen supported Stephen Green's conclusions, telling CODEL Boehner the stimulus package clearly has boosted growth in the short-term but may be harmful in the long-run. Officials at the Semiconductor Manufacturing International Corporation (SMIC) said production in SMIC's Shanghai factory dropped to a low point of 30-40 percent of capacity by the beginning of 2009. During the first half of the year, however, SMIC has benefited from a surge in China's domestic spending as a result of the stimulus, and the factory is now producing at 70 percent capacity. An American construction company representative told Congressman Bonner that many small

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infrastructure companies also benefited directly from the stimulus package. Also in line with Green's analysis, a corporate lawyer cautioned, however, that the surge in bank loans is not sustainable and could lead to large numbers of non-performing loans.

Comment

¶11. (SBU) Stephen Green is a trusted, long-time contact of the Consulate. In his analysis, he tends to rely heavily on statistics, and thus he has wrestled with the many thorny questions raised by China's economic statistics reporting system, which clearly resonated with the visiting Congressional delegation. His forward-looking critique and perspective on Beijing's stimulus measures emphasized the importance of utilizing non-traditional data sets in order to compensate for unreliable Chinese figures.

¶12. (SBU) CODEL staff cleared this report.
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